

## Box 11

**METHODOLOGICAL CHANGES IN THE COMPILATION OF THE EURO AREA BALANCE OF PAYMENTS AND INTERNATIONAL INVESTMENT POSITION**

In the last few years the euro area balance of payments (b.o.p) has been characterised by a growing statistical discrepancy between the current and capital accounts and the financial account, which conceptually should sum to zero. This has been reflected, since 2004, in an increasingly negative “net errors and omissions” component (see Chart). As this proved to be a non-transitory phenomenon, the ECB and the euro area national central banks initiated work on enhancing the method of compilation of the euro area b.o.p. and thereby reducing the net errors and omissions. While the resulting methodological changes have had a rather limited impact on recent major trends in the euro area b.o.p. and international investment position (i.i.p.) series, they have produced a significant “level” adjustment in 2008, having a downward impact on net financial inflows and improving the euro area’s net liability position vis-à-vis the rest of the world.

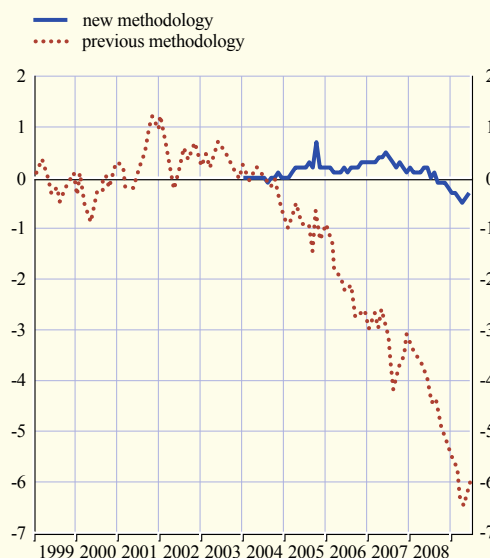
Historically, the b.o.p. was compiled on the basis of reports prepared for the purpose of foreign exchange controls. When such controls were abolished, the b.o.p. began to rely on information from bank settlements. However, as a result of developments in the organisation of international markets and information technology, bank settlements data started to diverge from the underlying transactions, in particular due to differences in timing, the classification of b.o.p. items and

geographical allocation. In most euro area countries b.o.p. compilation is now based on surveys rather than settlements data, which have reduced the burden on respondents, but are also subject to sampling and other errors, which appear to have become sizeable since 2004.

Against this background, the methodology for three financial account items has been improved, as from 2004, by incorporating information that was previously not used in the compilation of the euro area b.o.p. and i.i.p., such as intra-euro area transactions and positions. As a result, revisions have been directly introduced into the aggregate euro area b.o.p., to adjust for asymmetrical intra-euro area recording (see the points below). These revisions have reduced the euro area portfolio investment liabilities and increased the foreign assets held by euro area residents in loans and deposits, as recorded in the financial account category “other investment”.

### Net errors and omissions in the euro area balance of payments

(cumulated totals; first quarter 1999 to second quarter 2009; as a percentage of GDP)



Sources: ECB and ECB calculations.

Specifically, the following inconsistencies have been addressed by the improved methodology:

- A comparison between the portfolio investment liabilities of each euro area country and the respective assets held by residents abroad, using data from the IMF’s Coordinated Portfolio Investment Survey, revealed that euro area residents’ holdings of equity securities issued in Luxembourg and Ireland (by investment funds) were underestimated. This seemed to be associated with an under-reporting of euro area households’ holdings of investment fund shares.
- A geographically asymmetrical recording of transactions between euro area countries was observed for loans between non-monetary financial institutions (non-MFIs). The reporting of more assets than liabilities in the case of intra-euro area loans was mostly attributable to difficulties in the statistical coverage and residency classification of financial vehicle corporations. As a result, some of these transactions have been reclassified to counterparts located outside the euro area.
- Finally, evidence from the BIS banking statistics showed an underestimation of non-MFIs’ deposits held abroad. Many of those deposits may in fact be held by euro area households.

The implementation of the new methodology for these three items<sup>1</sup> together with the annual country data revisions has entailed substantial adjustments in the financial account, while changes to the current account figures have been marginal and mostly due to revisions affecting the income account. Overall, this new methodology has significantly reduced the statistical discrepancy in

<sup>1</sup> The related end-period positions in the euro area i.i.p. have been adjusted accordingly.

the euro area b.o.p. (see chart). For the period from the first quarter of 2004 to the second quarter of 2009 these revisions resulted in a reduction in the negative cumulated net errors and omissions from €555 billion (6.1% of euro area GDP) to €30 billion (0.3% of GDP). Most of this reduction (€430 billion) was due to the new methodology, as opposed to other revisions. Although the impact on the patterns in the time-series of the adjusted b.o.p. items<sup>2</sup> was limited, the magnitude of the effect on the i.i.p. was considerable. The euro area's net liability position for 2008 was revised downwards from 19.5% to 17.7% of GDP, with the methodological adjustments accounting for a decrease equal to 4.5% of GDP (this being partly offset by upward revisions arising from the country data). The current account deficit for 2008 was revised upwards by 0.4% of GDP (from 1.1% to 1.5% of GDP), of which only 0.05% of GDP can be directly related to the new methodology, as the income account was adjusted as a result of the changes to the i.i.p. Overall, with these methodological changes, the external financing of the euro area, as presented by the financial account, has become more aligned with the developments on the non-financial side of the economy, in particular developments in external trade in goods and services.

The financial account of the euro area b.o.p. and the related stocks in the euro area i.i.p. have been based on the new improved methodology – implemented consistently for all compiled frequencies – as from the press release published on 2 November 2009.

2 Further information is available on the ECB's website in the "Balance of payments and international investment position" sub-section of the "Statistics" section (<http://www.ecb.europa.eu/stats/external/balance/html/index.en.html>).